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In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 326

JULIUS MENDELSON and PEARL MENDELSON, his wife, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 34-43)[1] are not officially reported. The opinion of the Court of Appeals (Pet. 21-26) is not yet reported.

JURISDICTION

The judgment of the court of appeals was entered on July 17, 1962. The petition for a writ of cer-

[1] References designated "R" are to the appendix to petitioners' brief in the Court of Appeals.

tiorari was filed on August 13, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the Tax Court's determination of taxpayer's income derived from tips was arbitrary and unreasonable.

STATUTE INVOLVED

Internal Revenue Code of 1954:

> SEC. 446. GENERAL RULE FOR METHODS OF ACCOUNTING.
>
> * * * *
>
> (b) *Exceptions.* If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary or his delegate, does clearly reflect income.
>
> * * * *

STATEMENT

The facts, part of which were stipulated (R. 14-26, 32-34), may be summarized as follows:

During 1957 and 1958, petitioner, Pearl Mendelson,[*] was employed as a part-time waitress at the

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[*] Petitioners filed joint income tax returns for the taxable years in issue. Inasmuch as petitioner Julius Mendelson appears as a party only because of this fact, he will not be referred to hereafter.

El Dorado Restaurant in Wauwatosa, Wisconsin (R. 35). The restaurant, which featured liquor, steak and seafood, served lunch for $1.15 and dinners ranging from $2.75 to $5.50 (R. 36). It had a lower level, and an upper level used to seat the overflow crowd as well as occasional parties (R. 35).

When petitioner reported for work, she was assigned a station of four or five tables and served both food and liquor to her customers (R. 36). Her pattern of work was similar to that of the other waitresses at the El Dorado. Before the busy hours, she would set up her tables and clear her station. She served customers at lunch from approximately noon until 2:00 p.m. After that, she cleaned her station, checked out and went home. At the dinner hours, a similar procedure was followed. It was the practice to rotate waitresses among different stations, and petitioner was not stationed on the upper level more frequently than the other waitresses (R. 36). Although some of the waitresses performed hostess duties and occasionally were assigned to the restaurant's checkroom, petitioner was employed solely as a waitress during both of the years in issue (R. 37, 41). She was an average waitress among a group of waitresses, all of whom were good (R. 36).

The records of the El Dorado indicate that in 1957 she worked a total of 1,409 hours; in 1958, she worked 1,582 hours (R. 38). Her wages as a waitress during these years ranged from $.70 to $.75 per hour (R. 37), and she reported income from wages of $1,172.76 and $1,345.95, respectively (R. 35). For 1957, petitioner reported income from tips in the

sum of $200. She reported no such income for 1958 (R. 35).

The tipping practice at the El Dorado depended primarily on the quality of the service and the quality of the food. Tips ranged from nothing to more than 15% of the bills. Tipping was higher on the lower level of the restaurant than on the upper level. In some instances, customers left without paying their checks or tipping. During the baseball season, the restaurant served large groups of fans who ordered little food and accordingly left only nominal tips (R. 37).

Petitioner herself maintained no records concerning her restaurant employment (R. 38). The restaurant's records indicated the following (R. 38):

	1957	1958
Total food sales	$298,026	$301,039
Total liquor sales	130,440	128,330
Portion of liquor sales served at tables	78,264	76,998
Total hours of all waitresses, inclusive of time as hostess and in checkroom	23,082	23,155
Total hours of all waitresses, exclusive of time as hostess and in checkroom	19,949	20,621
Total hours worked by petitioner as waitress	1,409	1,582

Because figures showing the amounts of food and liquor served by each waitress were unavailable for 1957 and 1958 (R. 39), the Commissioner determined the amount of tips received by the petitioner in each of those years in the following manner. First, he added together total food sales and liquor sales

at the tables. This sum was then divided by the total hours worked by all waitresses as waitresses to determine the average amount of food and liquor served per average waitress-hour. Next, this quotient was multiplied by the total number of hours worked by petitioner as a waitress to find the total amount of food and liquor served by her during each taxable year. Finally, a rate of 12% was applied to this last amount to determine her tips for the year. Although the Commissioner determined that a rate of 15% was properly applicable to the tipping situation at the El Dorado, he reduced the rate to 12% to take account of the portion of their tips waitresses were required to pay over to the bus boy and to the hostess (R. 39). Under this formula, the Commissioner determined that petitioner had received $3,123 in tips during 1957 and $3,470 during 1958. (R. 39-40.)

The Tax Court accepted as fair and reasonable the method used to determine the amounts of tips received by petitioner (R. 42). In the light of evidence showing fluctuation in the general tipping percentage, less tipping on the upper level of the restaurant, nominal tipping by baseball fans, occasional skipping by customers without paying checks or leaving tips, and reduced tipping on combined food and liquor checks, the Tax Court concluded that a rate of 10% rather than 12% would correctly approximate the amounts petitioner received. Using 10%, the Tax Court determined that during 1957 and 1958 petitioner received income from tips of $2,660 and $2,900, respectively (R. 43).

A decision was entered (R. 48) by the Tax Court determining deficiencies in income taxes due for 1957 and 1958 of $536.56 and $717.23, respectively, together with penalties of $26.83 and $35.86, respectively.

Petitioners sought review of this decision, and the Court of Appeals affirmed (Pet. 21-26), holding that the method employed by the Commissioner to determine petitioner's income from tips was within his statutory power, and that the decision of the Tax Court was amply supported by the record.

ARGUMENT

When the taxpayer keeps no records the Commissioner is directed to compute taxable income under such method as, in his opinion, "clearly reflect[s] income". I.R.C. 1954, § 446(b), *supra*. The method used here was reasonably calculated to show petitioner's income from tips during the taxable years in issue.

1. In attempting to reconstruct petitioner's income from tips for 1957 and 1958, the Commissioner was faced with the fact that she had kept no records which reflected these amounts. Furthermore, neither the petitioner nor her employer had any records which would show the total amount of food and liquor billed to customers by petitioner in either year. Under these circumstances, it was proper for the Commissioner to use any practical method available to determine her tip income, including circumstantial proof. *United States* v. *Doyle*, 234 F. 2d 788 (C.A. 7th).

The method employed relied upon stipulated records maintained by the El Dorado Restaurant. Essentially, the Commissioner determined petitioner's tip income in two steps: (1) a computation of the total amount of food and liquor presumably served by her during each year; and (2) application of the local tipping percentage to her total billings for each year. In the absence of records showing the sales of each waitress, the Commissioner's method of arriving at the first figure was plainly reasonable. It approximated, as nearly as was possible, the dollar volume of petitioner's sales over the years in question. The tipping percentage applied accurately reflected the custom prevailing at the establishment.

Despite her blanket complaint (Pet. 5) that this is a faulty procedure, petitioner is unable to show that it is unfair or unreasonable. Nor does she suggest a better method. It is well settled that Section 446(b) does not require that the Commissioner's computation be entirely free from error. *Huntington Securities Corp.* v. *Busey*, 112 F. 2d 368 (C.A. 6th). The Commissioner has broad discretion to adopt a method which he believes will clearly reflect the income of the taxpayer, and his selection must stand unless petitioner can make a clear showing that he abused his discretion. *Lucas* v. *American Code Co.*, 280 U.S. 445, 449; *Standard Paving Co.* v. *Commissioner*, 190 F. 2d 330 (C.A. 10th).

2. The main thrust of petitioner's argument is directed against the findings of fact. But this argument is necessarily confined to matters not covered by the stipulations. As already noted, the records maintained by petitioner's employer were admitted

(R. 14, 38). These included total food and liquor sales, as well as the number of hours petitioner worked as a waitress.

The contention is made (Pet. 17-18) that the Commissioner failed to take into account certain factors tending to reduce the amount of tips received. However, as the Tax Court's opinion makes clear (R. 42-43), the Commissioner had allowed for kickbacks to bus boys and hostesses, and the tipping rate was further reduced to 10% by the Tax Court itself when it found that other evidentiary factors had not been given sufficient weight. This same contention was made in the Court of Appeals and rejected (Pet. 26).

Petitioner also claims (Pet. 7) that the testimony of the Commissioner's witness, Margaret Campbell, was disregarded. But the Tax Court was entitled to rely on the stipulated facts which indicated that petitioner spent no time as a hostess or in the checkroom (R. 33-34). And, in any event, the testimony cited (Pet. 7) shows that Margaret Campbell was uncertain whether petitioner had acted as a hostess in 1957.

3. There is no conflict of decisions. The question involved is simply whether the record supports the Tax Court's decision. Contrary to petitioner's assertion (Pet. 19), there is no important question of federal law to be settled. Petitioner, instead, merely seeks a review of the evidence and the inferences to be drawn from it. *General Talking Pictures Corp. v. Western Electric Co.*, 304 U.S. 175.[2]

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[2] Petitioner also states (Pet. 4) that she seeks review of the additions to the tax imposed under Section 6653(a) of

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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September 1962.

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the 1954 Code. These penalties, amounting to 5% of the underpayment in tax for each year, were sustained by the Tax Court since petitioner had failed to keep any record of the tips received in 1957 and 1958. Petitioner having introduced no evidence to rebut the Commissioner's determination that the additions were properly owing, they are not now subject to review.

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